Investment Outlook

Summary

Late-cyclical phase is still sustainable

May/June 2018

The world economy is continuing to grow at a healthy pace and inflation remains under control. Yet geopolitical uncertainty, concerns about inflation trends and questions about the durability of the cyclical upturn generated stock market turbulence early this year. Inflation is slowly moving higher due to rising salaries and commodity prices, but monetary policy normalisation will be delayed in many countries. Volatility may last for a while, but the strength of both the economy and corporate earnings makes us upbeat about stock market trends in the coming year. We are sticking to an optimistic view and are forecasting global economic growth of around 4% both in 2018 and 2019.

RISK EXPOSURE	
2017 Q4	2018 Q1
SLIGHTLY OVERWEIGHT	OVERWEIGHT

Our risk exposure is based on the proportion of equities in a diversified portfolio. The weight of equities is described as underweight, neutral or overweight. What a neutral weight is will depend on what risk profile the individual portfolio has.

Economic outlook – Regions

US – Continued growth, trade tensions at risk

After a temporary slump in the first quarter of 2018, we expect GDP to accelerate again during the next few quarters, driven by a strong labour market, tax cuts and business investments. American trade policy has become clearly protectionist, and trade tensions between the US and China are a downside risk. We expect inflation to accelerate during 2018, and the US Federal reserve (Fed) will hike its key interest rate three more times this year and twice in 2019, while shrinking its balance sheet as planned. We are sticking to our forecast that GDP will increase by 2.8% in 2018 and 2.5% in 2019.

Euro zone – Temporary hesitation

Despite a hesitant start to the year, due among other things to weather-related factors, a growth dynamic will dominate 2018-2019. Strong labour markets, looser fiscal policies and healthy global demand will offset the headwinds from a strong euro and trade worries. We believe that GDP will increase by 2.4% in 2018 and by 2.3% in 2019. Although more and more companies are complaining of recruitment problems, the rate of salary hikes and inflation will remain low. Together with certain structural reforms, this will make a further downturn in unemployment possible. The ECB will not hike its key rates until summer 2019.

Emerging market countries – Many thigs looking good

Most emerging market (EM) countries are contributing to healthy global growth. World trade has clearly rebounded, benefiting these often export-oriented economies. Along with continued commodity price stabilisation and improved current account balances in the most vulnerable countries, this makes the overall situation better than for years. EM growth is fastest in Asia, whereas commodity-dependent Latin American countries and Russia are growing more slowly – but with better momentum than in recent years. The latest commodity price trend is contributing positively to this. Many Eastern European nations are also showing favourable economic performance, among other things due to healthy demand from Western Europe.

China – Continued robust growth

We expect China to deliver continued high but slower GDP growth in 2018-2019, as planned. Beijing's prioritised debt reduction measures, which will slow the domestic economy, will be offset by periodically more expansionary monetary and fiscal policies. The Chinese yuan will appreciate further against the US dollar, partly as an expression of foreign investors' increasing appetite for Chinese equities and bonds. A stronger yuan will also decrease the risk of unwanted inflation surprises, while making debt reduction easier and Beijing-Washington trade relations less tense.

Sweden – Good economic momentum

Driving forces are changing: home construction will slow in 2018 and industry will take over as a growth engine. Households are in a good mood and employment is rising, but partly due to low salary hikes, consumers are hesitant and their savings ratio remains high. Thanks to sharp krona depreciation and rising energy prices, inflation will end up above Sweden central bank's 2% target during much of 2018. The central bank wants to see evidence that the strong economy is having an impact on salaries and service prices, which creates a risk that it will postpone its key rate hike until 2019. We expect GDP to grow by 2.6% this year and by 2.2% in 2019.

Expected risk and return in asset classes in the next 12 months

ASSET CLASS	TACTICAL EXPECTATION (12 months)	
	RETURN	RISK
EQUITIES		
Global	7.0%	12.6%
Emerging markets (local currencies)	9.5%	14.3%
Sweden	8.1%	12.6%
FIXED INCOME INVESTMENTS		
Government bonds	-1.1%	1.7%
Investment grade (IG) corporate bonds	0.9%	3.2%
High yield (HY) corporate bonds	3.0%	5.2%
Emerging market (EM) debt	4.0%	11.1%
ALTERNATIVES		
Hedge funds	3.5%	6.0%
Commodities	3.1%	11.8%

Tactical expected return is based on the SEB House View as of September 4, 2017. Index/basis for estimates: Global equities – MSCI All Country World Index in local currencies. Emerging markets – MSCI EM TR in local currencies. Swedish equities – SIX Portfolio Return Index in SEK. Government bonds – OMRX T-bonds in SEK. Corporate bonds (IG and HY), IBOXX Investment Grade Index in USD and IBOXX High Yield Index in USD. EM debt – JP Morgan Emerging Markets Bond Index in local currencies. Hedge funds – HFRX Global Hedge Fund Index in USD.

Equities

Optimistic, but more stock market uncertainty

In recent months, the upward stock market trend has been replaced by more volatile markets. Our still-positive fundamental outlook suggests that this is a correction, rather than a trend reversal. But the growth picture no longer has room for acceleration, and some investors are now pondering the next trend after several good years of growth. We expect modest stock market upturns for another while, but also greater volatility as the growth outlook deteriorates and as central bank stimulus increasingly fades. This late in the economic cycle, we see limited room for valuation-driven rallies. On the other hand, given the strong present growth we see little reason for valuations to come down significantly. Share prices should thus keep almost pace with earnings, rising 6-10% in the next 12 months.

Fixed income investments

A divided central banking world

The latest central bank announcements are divergent, with continued interest rate hikes by the US Federal Reserve (Fed), while the European Central Bank (ECB) and Sweden's Riksbank have not yet shown any signs of being in a hurry to begin tightening monetary policies. Looking ahead, spreads between key rates will widen even further, while moderate inflation pressure will limit the upturn in long-term yields. Due to historically low interest rates and yields, many traditional fixed income investments are providing little or no returns. When market rates climb, it means poorer conditions for the fixed income market in general and investments with long maturities in particular. Low interest rates also limit potential returns on investment grade (IG) and high yield (HY) bonds, but we see greater potential in HY since they are not as sensitive to rising bond yields.

Alternative investments

Changed market, better or worse for hedge funds

Early in 2018, stock markets were volatile. For some hedge fund strategies, this may have been manageable, but for others these types of movements can be unfavourable. Managers in trend-following strategies began the year strongly but are hampered by increasing market movements. Changes in the monetary policy landscape will create opportunities for macro strategies. Clear differences in returns between markets, sectors and individual equities, as well as diminishing political risks, will create potential for equity long/short strategies.

Source: SEB Investment Outlook, May/June 2018

Glossary

Terminology used	Explanation
Fiscal policy	Fiscal policy relates to government spending and tax collection. Fiscal policy refers to the use of the government budget to influence economic activity. For example, when economic growth is slowing down, the government can step in and increase its spending to stimulate demand and economic growth. Or it can lower taxes to increase disposable income for people and businesses.
Gross Domestic Product (GDP)	The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.
Hedge funds' strategies	Market neutral strategy – a strategy by hedge fund managers, that seeks to profit from both increasing and decreasing prices in a single or numerous markets. Event-driven strategy – a strategy, adopted by hedge fund managers, that attempts to take advantage of events such as mergers, acquisitions and restructurings that can result in the short-term mispricing of a company's stock. Relative value strategy is a catchall for a variety of different strategies used with a broad array of securities. The underlying concept is that a hedge fund manager is purchasing a security that is expected to appreciate, while simultaneously selling short a related security that is expected to depreciate. Trend-following strategy (i.e. commodity trading advisers, CTA) – investment strategy based on the technical analysis of market prices, rather than on the fundamental strengths of the companies. In financial markets, traders and investors using a trend following strategy believe that prices tend to move upwards or downwards over time. They try and take advantage of these market trends by observing the current direction and using this to decide whether to buy or sell.
Household (private) consumption	Transaction of the national account's use of income account representing consumer spending. It consists of the expenditure incurred by resident households on individual consumption goods and services, including those sold at prices that are not economically significant.
Investment grade bonds, high yield bonds	Investment grade bonds – bonds (sovereign or corporate) with credit ratings that indicates a relatively low risk of default. High yield bonds – bonds (sovereign or corporate) with credit ratings that indicates a relatively higher risk of default than investment grade bonds. Because of the higher risk of default, these bonds pay a higher yield than investment grade bonds. Two main credit rating agencies Standard & Poor's (S&P) and Moody's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. S&P designations of 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as high yield or "junk bonds".
Monetary policy	Monetary policy is the process by which the monetary authority (usually the central bank) of a country controls the supply of money (the size and rate of growth of the money supply), for the purpose of promoting economic growth and stability. For example, if the money supply grows too fast, the rate of inflation will increase and the economy will "overheat". If the growth of the money supply is slowed too much, then economic growth may also slow. The main tools to control money supply include open market operations (buying or selling assets), changing interest rates and changing reserve requirements for commercial banks.
SEB Investment Outlook	A public release prepared by SEB economists, strategists and analysts. Investment Outlook gives readers an in-depth look at the investment climate and the prospects for seven asset classes. It also provides advice about current risks and opportunities in the art of investing. The report can be read in its entirety at www.sebgroup.com
Yield	The income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.